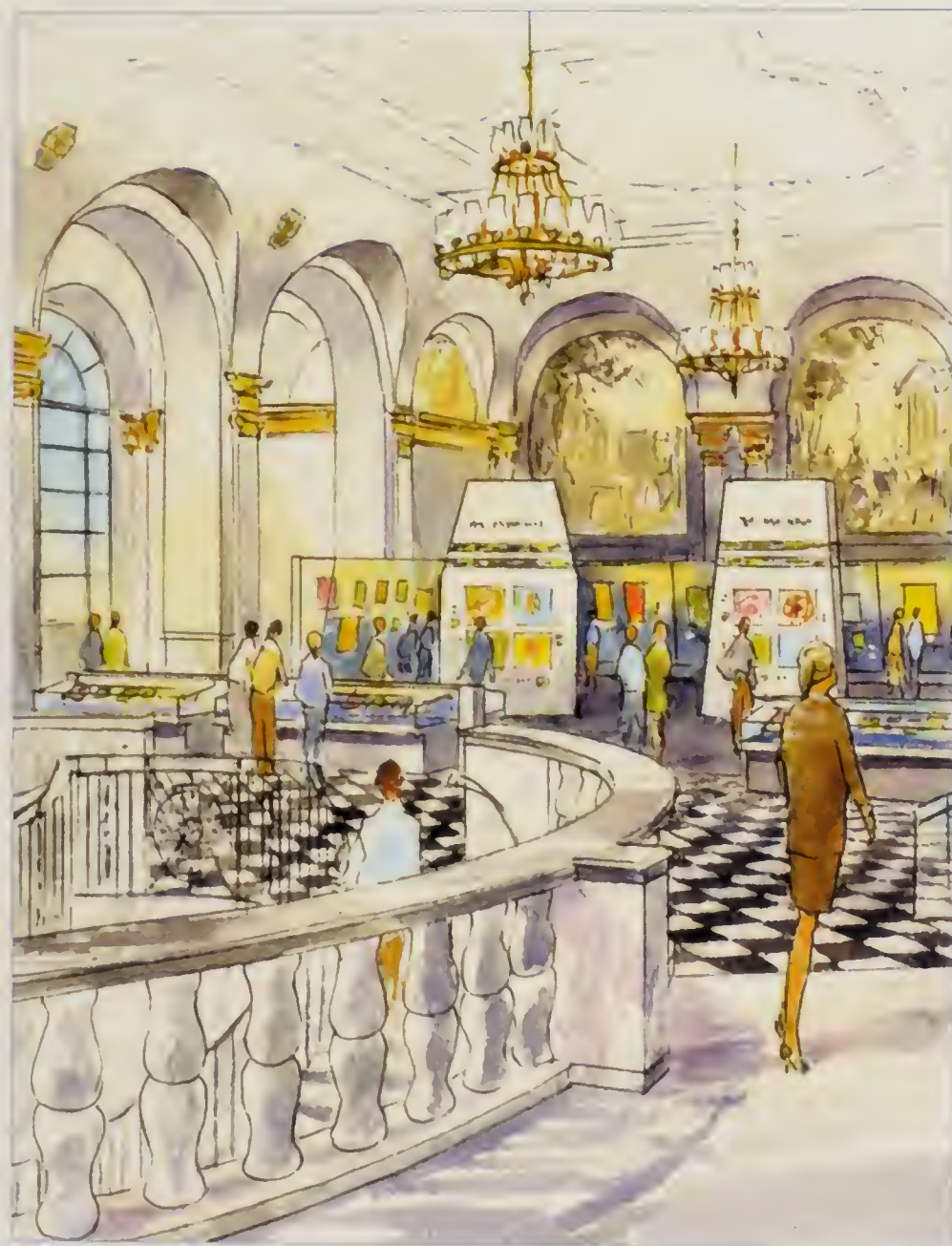


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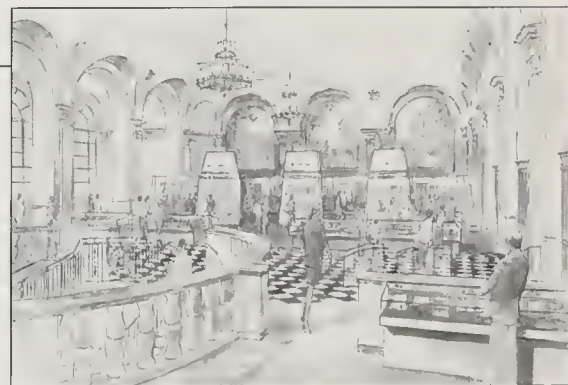
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rendering of the
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ascending the
magnificent stairs
at the Museum
entrance, visitors will
be greeted by dynamic yet
historically appropriate permanent exhibitions on the capital
markets, money, banking, entrepreneurship, and Alexander
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Message to Members

By Lee Kjelleren, Executive Director/CEO

On June 28, the Museum hosted the first of what it expects will be an ongoing series of symposia in its new home at 48 Wall Street on topics of national significance. The event, entitled "The Financial Future America Cannot Afford: A Call For Action," featured a distinguished panel of current and former presidential-level appointees on the subject of the US's unsustainable fiscal policies. David M. Walker, Comptroller General of the US, provided a basic factual framework using the US government's own figures, and panelists included Peter G. Peterson, prominent investment bank CEO, author, former Secretary of Commerce and current Chairman of the Council on Foreign Relations; William H. Donaldson, former corporate CEO, Chairman of the Securities & Exchange Commission and Chairman of the New York Stock Exchange; and Alice M. Rivlin, author and former Director of the White House Office of Management and Budget and Vice Chair of the Federal Reserve Bank. Myron Kandel, renowned CNN financial editor and commentator, moderated the discussion.

There was a clear bipartisan consensus among the panelists that the US faces a future in which every major category of federal spending is projected to grow as fast, or faster than, the economy, and *that the fiscal condition of the US is highly inappropriate and unsustainable for any country*, much less a great power. Comptroller Walker pointed out that we risk finding ourselves catastrophically buried under our own debt if our policies don't change.

The panelists emphasized that the public must be financially educated (the core of the Museum's mission) to



The panelists who participated in "The Financial Future America Cannot Afford" symposium were (L to R) Peter Peterson, David Walker, Myron Kandel (moderator), Alice Rivlin, and William Donaldson.

understand that due to our huge and growing operating deficits, we cannot fix our present and coming deficits without benefit cuts and/or large tax increases. We must simply stop spending more than we earn. Secretary Peterson noted, "We've done Lyndon Johnson one better—now we have guns and butter *and tax cuts*."

The panelists highlighted the following facts and statistics in their analysis of our current fiscal situation:

1. Our federal government's total estimated fiscal exposure (excluding state, corporate and consumer debt), made up primarily of publicly held debt and military/civilian pensions and unfunded commitments



William Donaldson, former Chairman of the SEC, speaks at the June 28 symposium.

(primarily Social Security and Medicare) now approximate an unsustainable \$46 trillion (\$46,000,000,000,000). This is larger than our current total GNP of around \$43 trillion and amounts to 90 percent of our country's total estimated net worth of \$51 trillion. In 2005 this dramatic debt burden was equal to \$156,000 per person,

\$375,000 per full-time worker, or \$411,000 per household. (According to Comptroller Walker, "Every household gets to pay off a mortgage but does not get a house.") The median household income in 2005 was \$44,000.

Under any realistic scenario, the US has become by far the world's largest debtor nation (in the 1980s

it was the world's largest creditor nation). We will not be able to grow our way out of this problem over the next 30 plus years because obtaining the revenue needed to pay for our federal government's debt obligations, current liabilities and unfunded fiscal commitments, would require real annual economic growth of over 10 percent every year for at least the next 50 years. In the 1990s the economy grew at an average of 3.2 percent a year, which was roughly indicative of the last 50 years.

2. According to Comptroller Walker, the Chief Actuary of the Social Security Administration projects that over the next 35 years the GDP will increase roughly 72 percent, Social Security 147 percent and Medicare 331 percent. Entitlements spending alone plus interest payments will in all probability exceed total federal revenues by 2020 (in today's dollars)—and that includes using the \$1 trillion Social Security surplus over the next 10

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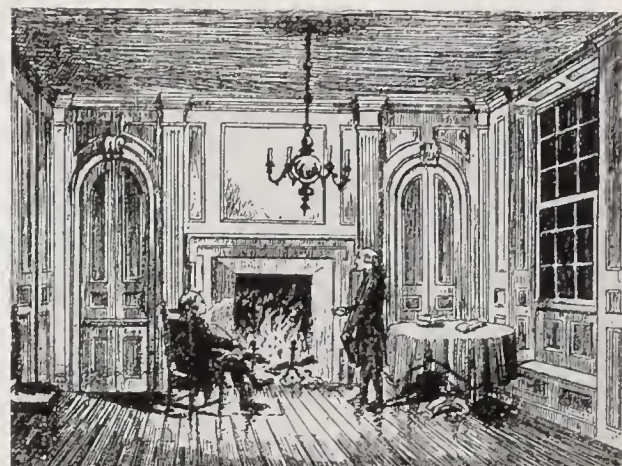
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Founder's Letter

By John E. Herzog, Founder and Chairman

Global warming has become a major topic of conversation, and the climate changes of the last 50 years or so are said to be very important in indicating future weather patterns, and much more. Alexander Hamilton surely didn't have these issues to worry about, although there probably were big hurricanes in his early years growing up on the island of Nevis in the Caribbean. But Hamilton could concentrate his attentions on subjects like human nature, commercial transactions and trading patterns, which gave him the skills and background he needed to become one of the greats among the Founding Fathers. Thus, we hope everyone will agree that a celebration of his birthday is appropriate.

The Museum will host a symposium and cocktail reception honoring Hamilton on January 11, 2007, the date of his 250th or 252nd birthday (depending on which historian you believe). The event will be held in the Museum's new home at 48 Wall Street



The Museum's "Alexander Hamilton Room" (L) will pay tribute to the living room of the Walton House (R), where the Bank of New York first conducted business.

and will give members, supporters and Hamilton enthusiasts an early glimpse at what the Museum will look like upon its opening in the spring.

Although most exhibitions will not be completed by January 11, the Museum's historic "Alexander Hamilton Room" will be ready and open for viewing during the event. The Bank of New York, founded by Hamilton in 1784, built this room based on images of the Walton House,

where the bank first conducted business. The room will be recreated as an 18th century environment, and various Hamilton related artifacts will be displayed there.

We hope you will "save the date" and plan to join us that day. If you would like to work on the event, please let us know. And, save your continental currency—you may be able to buy something with it on January 11th! **FH**

The Museum would like to thank these members for their generous recent gifts:

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Museum Unveils Exhibition Designs for 48 Wall Street

By Robert Vinci, Director of Exhibitions



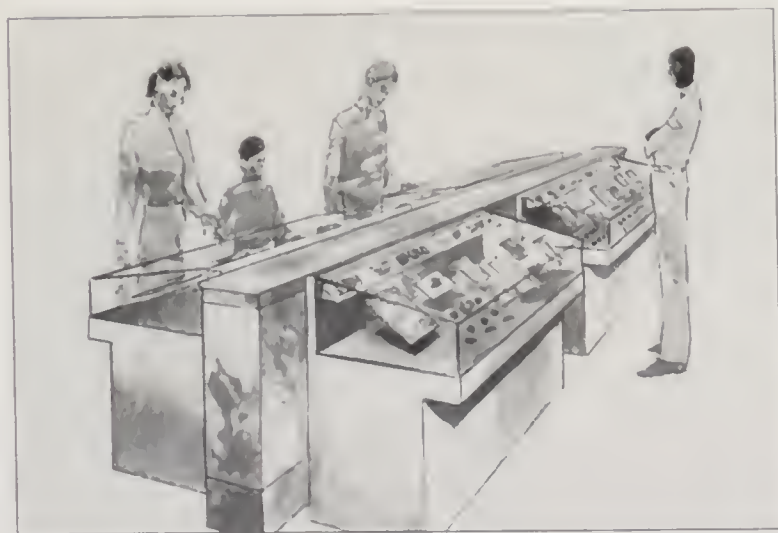
The largest of the Museum's permanent exhibits will be about the capital markets (stocks, bonds and commodities), and will line the William Street side of the exhibition space.

Permanent exhibitions. Ten times the space. School group tours, evening lectures, and book signings—all in one location. If you haven't heard, the Museum is about to take its biggest leap yet, all the way to Wall Street.

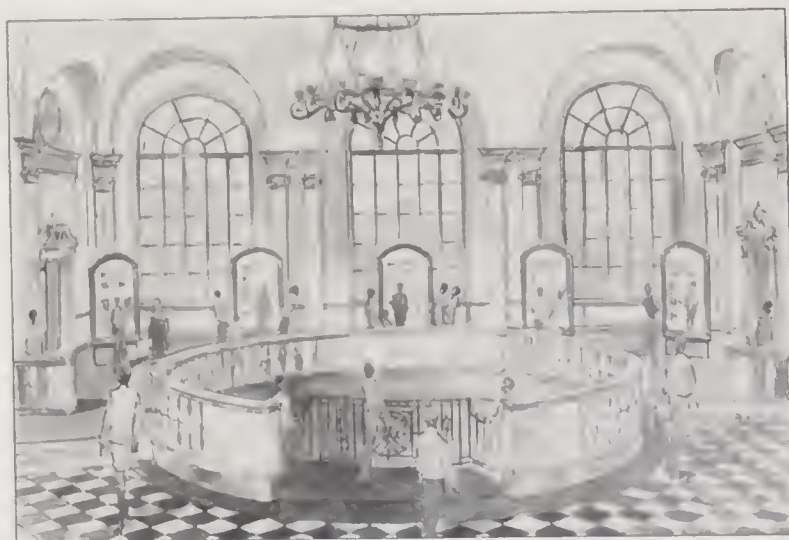
The Museum is changing locations after more than 15 years, and our trustees and staff are working hard to create a brand-new world class Museum dedicated to finance and entrepreneurial achievement. The large exhi-

bition space at 48 Wall Street will enable us to display both permanent and temporary exhibitions, and progress on exhibit designs and content is well underway. The magazine's cover and this page show watercolor renderings of some of the Museum's permanent exhibitions, designed by the prestigious New York-based design firm C&G Partners.

The permanent galleries will allow people of all ages to learn about the capital markets, the exchanges in New York and around the world, money, banking, entrepreneurship and the brilliance of Alexander Hamilton in helping to create America's economic system. The exhibitions will contain highlights from the collection, as well as some of the latest technological instruments in the financial field. Historic photographs, colorful graphics and engaging interactives will lead visitors to learn firsthand the benefits of investing. We will also continue to develop exciting temporary exhibitions on both historic and contemporary subjects. We guarantee it will be worth the visit. **FH**



This close-up of cases in the money and banking exhibition shows one of the ways in which historic artifacts will be presented.



The Wall Street side of the Museum will be an interactive exhibit on entrepreneurship.

Letter to the Editor

Dear Ms. Aguilera:

I always enjoy your magazine. In the issue I received today [#85], however, I noticed an error that has often appeared elsewhere (including in a Federal Reserve report). Dr. MacDonald's article about hedge funds states that the "first known hedge fund was started in 1949 by Alfred Winslow Jones."

It's true that Jones was an early practitioner in the hedge fund field. But Ben Graham managed a hedge fund in the mid-1920s. It involved a

partnership structure, a percentage-of-profits-compensation arrangement for Ben as general partner, a number of limited partners and a variety of long and short positions.

In the 1930s, Ben and Jerry Newman established both Graham-Newman Corporation, a regulated investment company and Newman and Graham, another entity with standard hedge fund characteristics. I was employed by both enterprises in 1954-1956 and received a monthly paycheck from Newman and Graham.

When I formed my own partnership in 1956, I was probably influenced in the structure I established by my knowledge of the Newman and Graham partnership.

Incidentally, I make no claim that Ben's mid-1920s partnership was the first. It's just the first that I know of.

Sincerely,
Warren E. Buffett
CEO
Berkshire Hathaway, Inc.

Of Interest to Members: Oil Industry Recalls Its History

By Gregory DL Morris

Earlier this year, ExxonMobil replaced Wal-Mart as the largest-capitalization stock on the New York Stock Exchange. The event merely confirmed that the business of oil remains dominant in global as well as local economies. Indeed the leading, sometimes the only

economic indicator that most people know is the price of gasoline.

In that environment the American Oil and Gas Historical Society of Washington, DC, and the Petroleum History Institute of Oil City, PA, held jointly the 2006 International Oil History Symposium in Wichita, KS, in late April. It was a unique gathering of professionals and aficionados in business history, scripophily, oil and local history museums, education, and geology. Of note, the oil industry and the picture postcard grew up together, so card collectors were almost as well represented as collectors of stock certificates for which the early oil industry is justly famous.

Oil was first found in Kansas in 1860, just two years after the world's first commercial well was

dug at Oil Springs, Ontario, and one year after Edwin Drake's famous gusher in Titusville, PA. The giant El Dorado oil field was found in 1915, east of Wichita, and the Midland Refinery was built nearby two years later. Midland was acquired by Skelly Oil in 1923, eventually becoming part of Getty, then Texaco, briefly a joint venture with Shell, and now Frontier Oil.

After a day and a half of papers and presentations, the highlights of the event were tours of producing Kansas oilfields, and visits to the Frontier Refinery and the Kansas Oil Museum, both at El Dorado. The AOGHS has an extensive list of oil and local history museums and sites across the country on its website, www.aoghs.org. **FH**





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Are Financial Newspapers a Thing of the Past?

By Dan Cooper and Brian Grinder

LAST SATURDAY AS I gingerly extracted my weekend edition of *The Wall Street Journal* from its rain-soaked plastic bag, I was greeted on the front page by four full-color photographs, a color line drawing of Wojciech Jaruzelski, and two of the *Journal*'s renowned "hedcut" or dot portraits. As I compared it to a photograph of the very first copy of the paper, I wondered if Charles Dow would even recognize his creation today.¹

The first issue was a four-page, four-column, text-only document that sold for two cents and had the singular purpose of reporting commercial and financial news on a timely basis.² According to *Time* magazine, not much had changed 70 years later when it remarked, "Measured by the tastes and habits of the ordinary newspaper reader, *The Wall Street Journal* front page is agonizingly dull. For determinedly conservative make up, the *Journal*'s front page—six solid columns of type unrelieved by a picture—has no rival among US metropolitan dailies." (See Wendt, p.360)

What *Time* missed, however, was that the audience for financial news was not and never had been up to that point in time "the ordinary newspaper reader." William Buck Dana, who founded the weekly newspaper *The Commercial and Financial Chronicle* in 1886, was very much aware that his was a special audience.

Historian Douglas Steeples notes that Dana "targeted his audience carefully...from a select group that played a commanding role in the development of a corporate economy

dominated by financial institutions. His readers were bankers, brokers, financiers, leaders of industry and top government officials."

These were rich, well-educated individuals with a desperate need for a specific type of information. This meant that the *Chronicle* and its successors were compelled to take a



Wall Street Journal "hedcut"
image of Bill Gates.

Courtesy of The Wall Street Journal

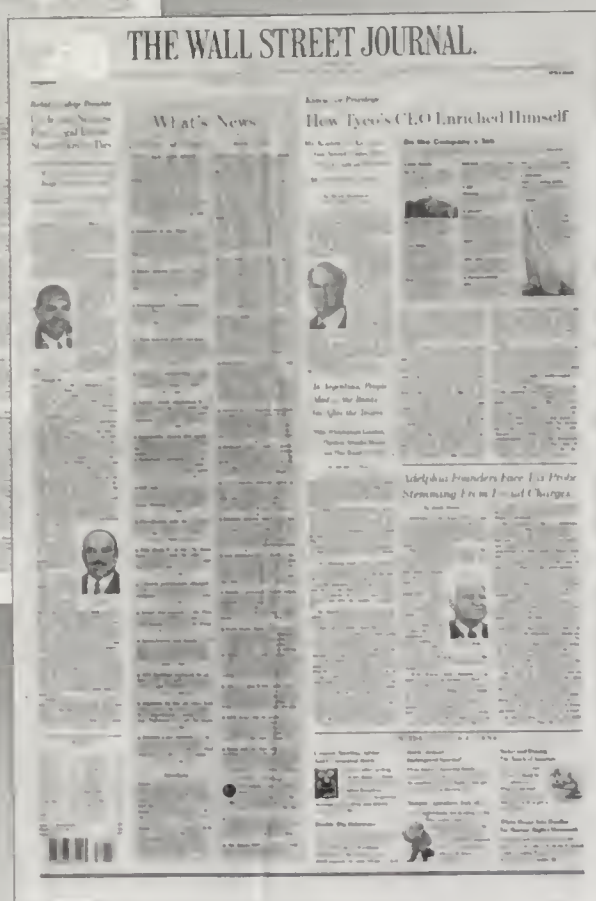
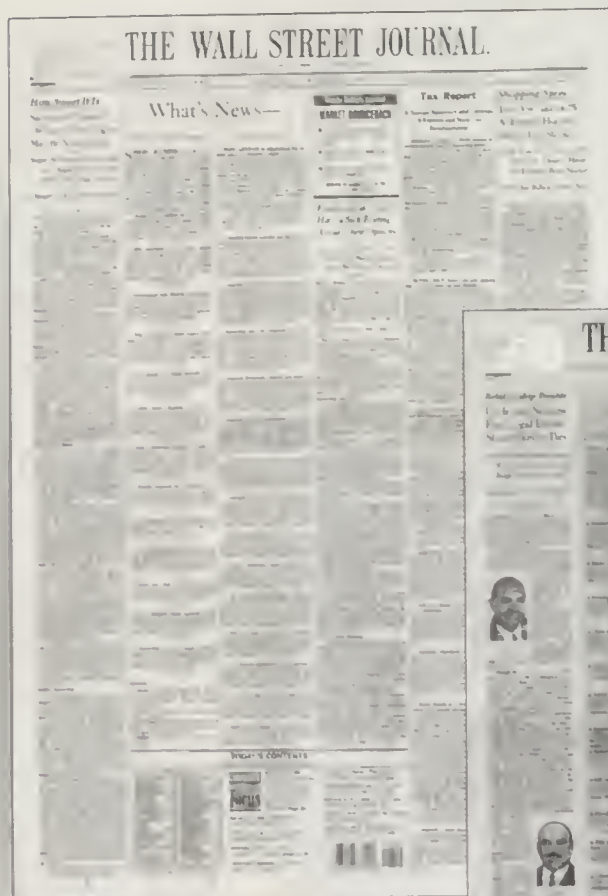
no-nonsense, just-the-facts approach to the news. Thus the sensationalistic yellow journalism that began with Joseph Pulitzer's purchase of the *New York World* in 1883 never tarnished the pages of the *Chronicle* or the fledgling *Wall Street Journal*. The focus of the financial press was to deliver facts and figures in a timely and accurate manner to Wall Street's

elite. This is why something like Thomas Nast's wildly popular illustrations from the 1860s and 1870s never appeared in the pages of the *Chronicle*. Such frivolities were beneath the paper's intended audience and a waste of valuable space that could be devoted to more important information.³

Both the *Chronicle* and the *Journal* were successful because they endeavored to provide accurate, unbiased news, and for years there was no better way for businesses to keep tabs on the economy or for investors to stay informed about securities prices than by subscribing to a financial newspaper. New technologies such as radio and television were unable to replace the newspaper's function as the timeliest provider of business information. The newspaper was simply the fastest and most convenient way to check stock prices (even if they were yesterday's closing prices) or read about the latest economic developments.

So why, you might be asking, does today's *Wall Street Journal*⁴ contain color photographs, hedcuts, cartoons, and the like? Why doesn't the 1959 *Time* magazine description of the *Journal*'s front page apply to today's *Wall Street Journal*?

The Wall Street Journal recently described itself at the middle of the 20th century as "a 19th-century-style newspaper—column after column, page after page of gray type packed with important news and statistics of the world of business and finance... There [was] no 'art,' such as photographs or drawings, only graphs and bar charts of things like railway



As recently as the late 1970s (top), The Wall Street Journal's front page was composed almost solely of solid text with business and financial information. Today, it more closely resembles other newspapers with photographs, "hedcut" dot portraits, graphs and charts.

shipments and pig iron production." But things were about to change as Barney Kilgore, then managing editor of the *Journal*, set out to transform the paper by expanding its focus and repositioning it as a truly national newspaper.

In 1949, editor William Grimes had sent cartoonist Charles Preston packing when he had the audacity to suggest that the paper needed a cartoon on its editorial page. Kilgore cagily waited until Grimes was on an extended vacation in Europe to hire Preston and introduce the daily "Salt...and Pepper" cartoon to the

paper as part of a revamping of the editorial page.

Kilgore also introduced many front page changes that are still a part of *The Wall Street Journal* such as the popular "What's News" feature and the often whimsical "A-hed" human interest column, but there would be no pictures or photographs on the front page for years. The long-held resistance to anything but text and graphs on the front page was nicely summed up by retired executive editor Fred Taylor who, on the occasion of the *Journal's* 100th anniversary, is reported to have said, "I always

thought that one word was worth a thousand pictures." Photographs and drawings were by and large relegated to advertisements.

The *Journal* began to use line drawn portraits in the 1970s, but they didn't look very good when they were shrunk down to fit the required half-column format. Artist Kevin Sprouls solved the problem in 1979 when he developed the now famous hedcut (also known as stipple art), which uses ink dots to draw the portrait. These portraits, which looked good in the small format, fit well in the context of the paper because of their resemblance

to the engraved artwork on stock and bond certificates. These time-consuming, hand-drawn portraits have survived into the Internet age because they have become a well-known *Wall Street Journal* trademark.

There are two additional factors that have forced the financial press to change the way it presents the news: (1) the change in the audience for financial news and (2) the Internet. The audience is no longer that narrow group Dana defined back in the 19th century. Over the years, a growing number of ordinary Americans have decided to invest their hard-earned dollars in the stock market. In addition, the change from defined-benefit to defined-contribution pension plans has meant that more retirement dollars are being invested in stocks, bonds, and various other financial securities. As a result, there is a greater interest in financial news amongst common, ordinary folk, and it is increasingly necessary that papers such as *The Wall Street Journal* appeal to this broader audience.

The Internet has made it easier for investors to access financial markets and has revolutionized the way financial news reaches us. Before the Internet, prices for financial securities were most easily tracked through the daily newspaper, but now anyone with access to the Internet can track stocks continuously throughout the day on either a delayed or real-time basis. The Internet has also broken the bounds of space limitation that have plagued print media for years⁵ and has allowed a plethora of additional information to be displayed along with traditional securities pricing information. All this has taken place without sacrificing the eyes of an aging population to smaller font sizes.

A trend that was sparked by the success of *The Wall Street Journal Online* is reduced coverage in print of

securities prices. The *Journal* has already eliminated individual stock option quotations from the print edition and offers complete futures prices and futures options data only online. A notice now appears in several places in the print edition of the *Journal* directing readers to wsj.com/free for complete listing information. It is inevitable that this trend will continue with most of the contents of the paper's "Money and Investing" section being transferred to the Internet.

In 2007, the *Journal* plans to reduce the width of the paper by three inches. Though this is a move that most other newspapers have already made and is in part driven by the increasing cost of paper, it may be a harbinger of the future for newsprint. Will newsprint be totally replaced by the Internet, or will something like e-paper eventually replace it and allow newspapers to simply rewrite themselves every day? Most importantly, will this eventually mean no more soggy papers on my doorstep? Regardless of the format, organizations such as *The Wall Street Journal* still have the same basic task to perform as they did from the start: deliver timely financial news in an accurate and unbiased manner. **FH**

Brian Grinder is a professor at Eastern Washington University and a member of Financial History's editorial board. Dr. Dan Cooper is the president of Active Learning Technologies.

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Notes

1. See the first set of picture insets in Rosenberg for a picture of the "First copy of *The Wall Street Journal*, July 8, 1889."
2. There was mention made of the Sullivan—Kilrain boxing match in column three.
3. The importance of Nast's illustrations cannot be understated. Nast was able to influence the 1864 presidential election, and aid in the downfall of Boss Tweed of Tammany Hall fame. Interestingly enough when Tweed fled to Spain, he was caught and returned to the United State by Spanish authorities who used a Nast cartoon to identify him. (See Ackerman, pp. 306-310.)
4. *The Commercial and Financial Chronicle* ceased publication in 1987.
5. For instance, Berkshire Hathaway common stock caused quite a stir at *The Wall Street Journal* when its price per share crossed the \$10,000 mark. Limitations on column widths made it difficult to fit the price on the page.

Triumphs of The One-Armed Economist: Fred Arditti and the Birth of Modern Derivatives

By Gregory DL Morris



FRED ARDITTI IS THE MOST important economist that almost no one has ever heard of. As chief economist for the Chicago Mercantile Exchange (CME) he developed the theory and then the business case for audacious new financial instruments, including eurodollar and weather derivatives, and also the demutualization of the CME. The eurodollar futures contract, launched in 1982, has become the most actively traded futures contract in the world.

"In terms of helping the world share risk, it would be hard to know how to calculate the gain in world welfare from the eurodollar contract," says William Sharpe, professor *emeritus* at Stanford University and co-winner of the Nobel Prize in economics in 1990. "The value of [the eurodollar contract] to the world has got to be staggering. Fred Arditti really was a giant."

Sharpe uses the past tense because Arditti died on October 30, 2005, after a long battle with cancer. He was just 66 years old, and is survived by his mother, his three adult children, two sisters, and a legacy of industry, perspicacity, and humility. "I hope at some point he said to himself, 'I've done a lot of great stuff,'" says Sharpe, "because he certainly would never have said it to anyone else."

Arditti's rare facility with both theory and operations led the inner circle of economists and business leaders to dub him the one-armed economist. "Fred could make a decision and get



Fred Arditti (C) with Leo Melamed (L), recipient of the 2005 Fred Arditti Innovation Award, and Nobel Prize winning economist William L. Sharpe (R).

things done," says Phupinder S. Gill, president and COO of the Merc. "He was not one of those economists who would always say, 'on the one hand...then on the other hand...'"

That penchant for practicality may have come from being born and raised in the Bronx (he was a life-long Yankees fan) or from an undergraduate degree in engineering at the Massachusetts Institute of Technology. Richard L. Greene, an undergraduate classmate and now professor of physics at the University of Maryland, recalls when Jimmy Hoffa gave a guest lecture to their class. Arditti fol-

lowed the Teamster boss after the class to arrange an exclusive interview the next day. The professor sent the resulting paper on corruption in labor unions to Hoffa for grading. It came back marked "A" with the note, "This kid's got a lot of guts."

That courage continued throughout his life. "He pursued learning relentlessly," says Gill. "In his classes he used to write on the board a lot, but when he became too weak to write, he learned advanced PowerPoint to create lecture notes. He created 400 pages of notes despite being on 120 pills a day in stage-four cancer.

Courtesy of the Chicago Mercantile Exchange

He fought the disease just as relentlessly as he pursued learning.”

Moving on to MIT's business school, Arditti studied under luminary professor Paul A. Samuelson, 1970 Nobel laureate. The professor was notoriously tough even for economics students, and he claimed that no mere business student had ever passed his class. Business student Arditti got an “A,” and finished first in the class. Samuelson got the last word, though, convincing him to transfer into the economics program. Arditti earned his Ph.D. in economics from MIT in 1966.

Arditti served several terms with the Merc, including as chief economist

from 1980-82. He also ran the CME's strategic planning, market research, and clearinghouse operations, according to Terry Duff, chairman of the Merc. An economist in charge of strategic development? “Every day people around the world benefit from the innovative financial instruments Fred created,” says Duff. “He was always willing to collaborate, educate, and inspire.”

Gill stresses that while Arditti's eurodollar and weather derivative developments are most recognizable to those outside the CME, his clearinghouse innovations remain crucial to the inner workings of the

exchange. “Our clearinghouse handles millions of transactions a day, and we cannot begin the new day without knowing the exact closing positions for the previous day. At 3:00 am every day we have to be balanced for positions and money. That is billions of dollars, down to the penny, every day. Fred did that.” He also notes that Arditti was an avid basketball player at 5'11”, and somehow had time to compile an extensive stamp collection.

Still, it is the eurodollar contract that resonates most because it was so iconoclastic in its day. According to Leo Melamed, chairman *emeritus* of the CME, he started pulling together ideas for financial futures in 1972, and brought Arditti in as chief economist in 1979 “to help advance the revolution.”

They had a tough challenge, because at the time futures could only be written on commodities for which physical delivery could be made. “Thanks to the work Fred did, it was ordained in 1981 that we did not need fixed physical delivery, but that cash in lieu of delivery was acceptable,” says Melamed. “The physical commodity was just to keep everyone honest.”

Arditti's next mission was to develop the eurodollar contract. “We wanted to launch on the day of approval,” says Melamed. “But we needed an index that was measurable and acceptable worldwide. It seems easy to say today, but at the time it was breathtaking. There was no precedent. Each bank had its own little interest rate. Fred developed the IMM index. It was beautiful in its simplicity. He decided on 14 banks, small and large. We throw out the two outliers, and average the remaining 12.”

Peter Barker, director of interest rate products for the CME recalls that “at the time, cash settlement was the most innovative thing in business. If you had talked to commodity and futures experts at the



Courtesy of the Chicago Mercantile Exchange

Fred Arditti, former chief economist for the Chicago Mercantile Exchange.



Betmann/ORBIS

Traders work amid a flurry of activity on the Lower Trading Floor at the Chicago Mercantile Exchange.

time, I guarantee a lot of them would have told you that could not work. But Fred knew it could work. Now everything is cash settled."

Melamed adds, "The eurodollar contract is one of the most important financial instruments ever launched, and the most successful of all CME contracts. Fred's formula for cash settlement for this very complex instrument is operational to this day."

On the wall in Melamed's office is a photograph of him with Merton E. Miller, who shared the 1990 Nobel Prize with Sharpe and Harry M. Markowitz. On the photo Miller wrote, "If I had come to the opening of the IMM, I could have been standing beside you when you began the modern era of finance."

That seminal work would have been sufficient to make a name for Arditti, but by all accounts Arditti was relentlessly industrious. "Fred was a major contributor to the literature at the crucial point when the field was really developing," says Sharpe at Stanford. "He was published in the premier academic journals: *The Journal of Finance*, *The Journal of Financial Quantitative Analysis*, *The American Economic Review*. And he was

quite diverse. He wrote on risk and return, mutual fund performance, and an array of issues in corporate finance." Papers written by Arditti in the 1970s are still being taught in business schools today.

His text, *Derivatives: A Comprehensive Resource for Futures Interest Rate Swaps and Mortgage Securities* (Harvard Business School Publishing, 1996), is also among the most widely assigned books on the subjects in many universities. "The book is encyclopedic," says Sharpe. "It is the theory, and a great deal of information on the institutional practice."

Far from just sending his written words, Arditti was an active educator throughout his professional career. He was chairman of the economics department at the University of Florida, and a professor of finance at DePaul University in Chicago from 1990 on. "When he joined this faculty, this university changed forever," says Ali Fatemi, alumni professor and chairman of the department of finance at DePaul.

Even off campus, Arditti was ever the student. "Fred was driven by two very strong forces," says Arman Falsafi, managing director at CME

Europe in London. "First was his endless curiosity about how the world works. And second was an infinite energy and drive to pursue knowledge and satisfy that curiosity."

To help preserve that drive, the CME established the Fred Arditti Innovation Award in 2004, and Arditti himself was the featured speaker when the first award was bestowed the following year. The CME's award is not the first to carry Arditti's name. Gill named his son after Uncle Fred.

"Fred was a deep thinker," says Melamed. And not just about finance and economics. "About sports, and movies [*Casablanca* was his favorite], and women, and the Classics, and food, and fashion. He could quote batting averages from players long gone, and when we would go out to dinner he would make countless selections. We would have to have a separate table for all the food. His breadth of knowledge was boundless, and his laughter was unabridged."

"The last thing he said to me was to follow through," Gill recalls. "I went to see him after a transfusion. We talked, and at one point he took a tissue to cough into. He rolled it in a ball and threw it at the dustbin, and missed. He tried to pick it up, but the housekeeper scolded him for trying to move—he could barely sit up. He coughed again, and again missed with the tissue. I tried to pick it up, but he told me not to, and to wash my hands. He was relentless about germs, too. With the next tissue he looked at me and said, 'It's all about follow-through. On your toes, and follow through.' And he did not miss." **EH**

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The Strange Birth of the SEC

By Matthew P. Fink



The first Securities and Exchange Commission with Chairman Joseph Kennedy (C).

MANY NEW DEALERS BELIEVED that the creation of the United States Securities and Exchange Commission was one of President Franklin Roosevelt's greatest achievements. William O. Douglas wrote in his autobiography, *Go East, Young Man*, "I told FDR over and over again that every agency he created should be abolished in 10 years [because] eventually they are transformed into spokesmen for the interest groups...The SEC was not like this in the early days...Forty years after the SEC was established it still had the best professional staff of

any agency in Washington."

Conversely, conservative critics considered the creation of the SEC to be one of FDR's worst mistakes. U. V. Wilcox, author of the 1940 book, *The Bankers Be Damned*, wrote: "For bankers generally, the Securities and Exchange Commission is the *enfant terrible* of the Franklin D. Roosevelt era. While other Roosevelt administration agencies of the government have mellowed over the years, the Securities and Exchange Commission has continued on its stormy way, determined to rule."

The debate continues to this day. On the liberal side, the website of the Franklin and Eleanor Roosevelt Institute proclaims, "The New Deal... led to the establishment of...the Securities and Exchange Commission...set up to stave off a further crash of the Stock Market." On the conservative side, Jim Powell's 2003 book, *FDR's Folly*, asserts, "By making it more difficult to raise capital, the SEC seems to have made recovery more difficult and thereby helped prolong the Great Depression."

The only new voice in the 70-year debate comes from some of today's disillusioned liberals, like Marty Jezer of CommonDreams.org, who alleges that the SEC no longer is "the kind of government [agency] that Franklin D. Roosevelt introduced in the 1930s," and that what is needed is a "new New Deal" to revitalize the agency.

But what these commentators—New Dealers, anti-New Dealers and disillusioned liberals alike—fail to acknowledge is that the SEC was not created at FDR's behest, but rather at the urging of his critics. In fact, Roosevelt opposed the creation of the SEC. If there was a "father" of the SEC, it was not the leader of the New Deal, but rather a leading opponent of the New Deal, Senator Carter Glass.¹

Collection of the Museum of American Finance

The Securities Act of 1933: The FTC Beats Out the Post Office Department

During his 1932 presidential campaign, Roosevelt called for a series of financial reforms, including requiring “truth telling” in the sale of securities and “the use of federal authority in the regulation of [securities] exchanges.” However, FDR did not provide details or specify which agency of government was to administer these two programs. After the election, Roosevelt and his advisers considered a series of different approaches.

First, Samuel Untermyer, a prominent New York attorney, drafted a bill that addressed both securities disclosure and exchange regulation. But the proposed bill had a fatal defect. Raymond Moley, a leading policy adviser to FDR, wrote in *The First New Deal*, “This bill would have placed the regulatory machinery in the Post Office Department, an obvious attempt to guarantee the measure’s constitutionality. I had told Untermyer—and Roosevelt agreed—that it would be unwise to burden what was essentially a service organization with such a complex system of regulation.”

Huston Thompson, a former Chairman of the Federal Trade Commission, prepared a second bill. Thompson’s bill dealt only with the sale of securities, did not address regulation of the exchanges, and placed regulatory authority in the FTC. The Senate went on to pass a revised version of the Thompson bill.

However, hearings before the House Commerce Committee convinced Committee Chairman Sam Rayburn and the White House that the Thompson bill was unnecessarily stringent. So a third bill was prepared by James Landis, a professor at Harvard Law School, and Benjamin Cohen, general solicitor of the Public Works Administration. Like the Thompson bill, the Landis-Cohen draft dealt solely with the sale of securities and

utilized the FTC as the regulator. The House passed the Landis-Cohen bill, with revisions.

A Senate-House Conference Committee reconciled the two bills, and on May 27, 1933, President Roosevelt signed into law the first federal securities law, the Securities Act of 1933.

The 1933 Act differed from the original Thompson and Landis-Cohen bills in a number of substantive areas. But there had been no objections to both bills’ designation of the FTC as the regulatory body, and the final 1933 Act retained the FTC in that role.

The Battle Over Exchange Regulation

The Roosevelt Administration then turned to the second area of securities regulation that FDR had advocated during his 1932 presidential campaign—regulation of the exchanges.

There were two very different types of proposals—one based on self-regulation by the exchanges with minimal government oversight; the other providing for direct government regulation of exchange practices in key areas.

First, FDR appointed a committee chaired by Secretary of Commerce



Although President Franklin D. Roosevelt has been widely credited with creating the SEC, the agency was not created at his behest, but rather at the urging of his critics.

Roper. Before the committee issued its report, one member, Henry Richardson, circulated a draft statute creating a new commission, which would have the authority to approve rules adopted by the exchanges. Two of the seven commissioners would be members of the exchanges. The Roper report was similar—it called for licensing of the exchanges by a federal regulatory authority which could be a new agency or a division of the FTC. One of the seven members

would be a representative of the exchanges. The report stated that “self-regulation should be emphasized...and the governing boards of the exchanges should, in the first instance, formulate...fair rules, subject to the veto of the Federal Regulatory Authority.”

A very different approach was taken in legislation drafted by a group of New Dealers including I.N.P. Stokes of the FTC, Telford Taylor, and Benjamin Cohen. The

draft did not call for the creation of a new federal agency which would only have the power to approve or veto exchange rules, but instead utilized the FTC, which was to have direct regulatory authority over the exchanges in areas such as price manipulation, segregation of broker and dealer functions, and the power to set margin requirements higher than those specified in the bill.

The bill was introduced in both houses and was greeted with a firestorm of criticism from the New York Stock Exchange, regional exchanges, brokerage firms and their employees, corporate issuers and others. The Federal Reserve Board objected to granting the FTC authority over margin. The New York Stock Exchange opposed the use of the FTC as the regulatory body and testified in favor of the creation of a new stock exchange commission.

The wave of criticism drove the New Dealers back to the drawing board. They came up with modifications that softened a number of provisions dealing with regulation of the exchanges. In addition, the revised bill granted authority over margin to the Federal Reserve Board. But it retained the FTC as the regulator of exchange practices.

These modifications failed to mollify the stock exchanges, who continued to oppose both substantive provisions and the use of the FTC. The Senate and House Committees still struggled to reach consensus.

Senator Glass's Proposal

Carter Glass was one of the most respected members of Congress on financial matters.

Glass had been the principal Congressional author of the 1913 legislation that created the Federal Reserve System and was often called “the father of the Federal Reserve System.” He saw himself as a protector of the Fed, and in particular wanted to keep it free from any



Betnam/CORBIS

United States Senator Carter Glass was a principal foe in the Senate of President Franklin D. Roosevelt's New Deal in the 1930s and was the driving force behind the creation of the SEC.

involvement with the stock market. Although personally friendly with President Roosevelt, he opposed much of the New Deal and, like the exchanges, he was distrustful of the reformers at the FTC.

Glass offered a proposal in the Senate Banking Committee to create a new agency, a three person Securities Exchange Commission, to replace the authority proposed in the bill for the Fed and the FTC. Glass's proposal was an attempt to kill two birds with one stone. First, the Fed, by losing authority over margin, would be kept free from entanglement with the stock market; and second, the reformist, ivory tower regulators at the FTC would be replaced by an agency of practical specialists in the securities markets. The Senate Committee, chaired by Senator Fletcher, adopted Glass's proposal, and the Senate passed a stock exchange bill providing for creation of the SEC.

FDR opposed the creation of the SEC. The leading historian of the SEC states: "Roosevelt and Fletcher... made a final attempt to restore the FTC as the administrative agency.... Ignoring long-standing custom, Fletcher chose not to name senior Banking Committee members Glass and Robert Wagner to the Conference Committee, since both favored the new Commission. Nearly simultaneously, Roosevelt informed a press conference that he 'personally' preferred... FTC enforcement."

But "the move to reinstate the FTC misfired badly. Roosevelt, embarrassed by accusations that he had attempted to influence the Conference Committee and had not originally objected to Glass's proposal... awkwardly retreated, informing the press that it was 'not a frightfully important thing, one way or the other' which agency enforced the stock exchange bill."²

The Conference Committee reconciled the bills passed by the Senate

and House, and on June 6, 1934, President Roosevelt signed into law the Securities Exchange Act of 1934.

The Creation of The SEC

The 1934 Act created a new federal agency, the United States Securities and Exchange Commission, to administer the Securities Act of 1933 as well as the 1934 Act. The 1934 Act gave the Federal Reserve Board the authority to establish margin requirements. And the 1934 Act gave the SEC some, but not all, of the federal control over the exchanges that the New Dealers had sought.

The final results reflected a number of ironies:

- Senator Glass had proposed the creation of a new commission so that it, rather than the Fed, would have authority over margin. But the 1934 Act lodged margin authority in the Fed.
- The exchanges had sought the creation of a new commission since they feared regulation by FTC officials. But FDR proceeded to appoint leading FTC officials as three of the SEC's first five commissioners.
- The exchanges had sought the creation of a new commission in the hope they could influence its decisions. But the SEC proved to be the most independent of agencies.

The actions of many individuals and groups contributed to the terms of the final legislation, including those establishing the SEC. One writer has concluded that "Virtually single-handedly, Glass was responsible for the creation of the Securities and Exchange Commission."³ While this may be an exaggeration, the record demonstrates that Senator Glass did play the critical role in the creation of the SEC.

The Federal Reserve Board building in Washington has a bas relief bust of Senator Glass, honoring "the father of the Federal Reserve System." The SEC recently moved to a new building in



Washington. This might be an appropriate time for the Commission to erect a similar monument to "Senator Carter Glass, the father of the SEC." **FH**

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Notes

1. The story of the SEC's creation, including the critical role played by Senator Glass, is set forth in the major histories of the SEC, including Ralph E. de Bedis, *The New Deal's SEC: The Formative Years* (New York and London, Columbia University Press, 1964); Michael E. Parrish, *Securities Regulation and the New Deal* (New Haven and London, Yale University Press, 1970); and Joel Seligman, *The Transformation of Wall Street* (3d ed., New York, Aspen Publishers, 2003). The history is also mentioned on the website of the SEC Historical Society, www.sechistorical.org/museum/galleries/kennedy/politicians_c.php.
2. Seligman, pp. 98-99.
3. Alfred Cash Koeniger, "Unreconstructed Rebel: The Political Thought and Senate Career of Carter Glass, 1929-1936," p. 109, Doctoral Thesis, Vanderbilt University, May 1980. Copyright by Dr. Koeniger.



THE **GOLD** CRISIS

AND

Johnson's Disengagement From Vietnam

By Gary R. Hess

IN A TELEVISED ADDRESS from the Oval Office on the evening of March 3, 1968, President Lyndon Johnson changed the course of American history. He began the disengagement of the United States from its divisive war in Vietnam. The opening sentence struck a dramatically different tone from Johnson's normal bellicose rhetoric; he said, "I want to talk to you about peace in Vietnam." He then announced an end to virtually all bombing of North Vietnam and willingness to negotiate with Hanoi at any time and in any place. To emphasize the point, he named the respected diplomat W. Averell Harriman as the US representative whenever negotiations did begin. Then, in a startling conclusion, Johnson withdrew as a candidate for another term as president.

Johnson's reversal of US policy is customarily explained within the context of the two previous months of turmoil in Vietnam and America beginning with the Tet Offensive. His speech came two months to the day after the communist forces in Vietnam had launched the largest and most surprising military operation of the war. North Vietnamese army

units and the Viet Cong, the southern guerrillas, took the war from the jungles into the cities, attacking South Vietnam's largest cities, nearly all of the provincial capitals, and other targets. Although caught by surprise, the Americans and South Vietnamese quickly regained control of nearly all of the cities, enabling Johnson to proclaim in late February that the Tet Offensive was a "complete failure." In strictly tactical terms, that was accurate, but the strategic impact of Tet was quite the opposite, for the ability of the communists to launch such a coordinated assault—which was captured in extensive television coverage—caused Americans to doubt the Johnson administration's claims of impending victory in Vietnam. Tet accentuated the downward trends in public support for the war and approval of Johnson's performance.

This discontent galvanized Senator Eugene McCarthy's anti-war campaign for the Democratic Party nomination and led to his unexpectedly strong showing in the New Hampshire primary on March 12. Just two days before that surprising indication of the president's political vulnerability, *The*

New York Times reported that the Joint Chiefs of Staff had requested that another 206,000 soldiers be sent to Vietnam, touching off extensive criticism in Congress and in the press. One senator warned the administration of an "incipient uprising" over the troop request.

Then Senator Robert Kennedy of New York announced his candidacy for the Democratic Party, presenting Johnson with a second and more formidable anti-war challenge. Johnson's March 31 speech thus was the culmination of a reappraisal of US policy forced upon him by the political ramifications of the Tet Offensive.

There was, however, an important economic dimension to Johnson's momentous step. The cost of the war had outstripped resources, contributing to a gold crisis. That devastating impact had not been anticipated by Johnson and his Keynesian economic advisers three years earlier when they assumed that the American economy could easily absorb the demands for "guns and butter"—waging war and building the Great Society at home. The chairman of the Council of Economic Advisers, Gardner Ackley, informed Johnson in

July 1965—the month that he made an open-ended commitment of US forces in Vietnam—that “our economy has lots of room to absorb a defense step-up... our productive capacity is growing by \$25-30 billion a year... making room for both more butter and, if needed, more guns.”

Indeed the projected war cost “could provide a significant stimulus to economic activity during the first or next year. [While] not saying a Vietnam crisis is just what the doctor ordered for the American economy... on a coldly objective analysis, the overall effects are most likely to be favorable to our prosperity.” When asked in a Senate hearing about how long the nation could afford war, Secretary of Defense Robert McNamara represented the same confidence. “I think forever,” he stated. “[There are] many prices we pay for the war in Vietnam,

some heavy prices indeed, but in my opinion one of them is not a strain on our economy.”

The Vietnam War had many “unintended consequences,” and its impact on fiscal policy was one of them. As American warfare escalated, with troop levels reaching 400,000 by the end of 1966 and over 500,000 a year later, the costs quickly outpaced projections and appropriations. By 1967, the war was costing \$2.5 billion per month and was a major factor in the growing federal budget deficit, which reached \$25 billion for FY 1968. Inflation, which had been modest during the early 1960s, rose significantly; the consumer price index increased 3.4% in 1966.

The deficit and inflation weakened the dollar, which had already been under pressure due to chronic balance-of-payments deficits. Strains in

the British economy led to London’s decision in late 1967 to devalue the pound sterling—a step which triggered a gold crisis and huge American losses from the gold pool. So even before the disastrous news from Vietnam beginning on January 31, economists and other observers feared that a continuing international monetary crisis could plunge the American economy into recession.

The world’s monetary structure, the Bretton Woods system, which established the US as the world’s banker depended upon international confidence in the American economy. Foreign currencies were tied to the dollar, whose value was set at \$35 per ounce of gold. Foreign central banks were willing to hold onto dollars, which were the basis of most foreign trade, provided access to



President Lyndon B. Johnson meets with General Creighton Abrams to discuss the partial halt to bombings in North Vietnam, March 1968.

Yochi Okamoto/CORBIS



President Johnson confers with General Earle G. Wheeler, Chairman of the Joint Chiefs of Staff, and other top advisers on the need for more US troops in Vietnam, 1968.

capital markets in the US, retained their purchasing power, and were backed by convertibility into gold. The US held some \$12 billion in gold stock, which represented about 75 percent of all the dollars held by other countries' central banks.

As the American economy showed war-induced problems in 1967, Walt W. Rostow, the economist who was Johnson's national security adviser, warned the president that, "even with large reserves the dollar can be shaken by a drop in confidence." Devaluation of the dollar and a concomitant increase in the price of gold, Rostow went on, would lead to a run on gold: "similarly, an inflationary rise in our prices can make [foreign banks] shift out of dollars...because they know inflation can lead to devaluation." A

Treasury Department report stated that "a strong US balance of payments would be a major factor in restoring confidence in the gold market," but during the last quarter of 1967 the United States had a \$7 billion deficit which threatened "an intolerable strain upon our and our partners' gold reserves." A no longer buoyant Ackley warned Johnson of a "risk of a critical deterioration of the world economic situation—one that could even lead to a world depression if prompt action were not taken to reverse it." Such concerns led a reluctant Johnson to request that Congress enact a 10 percent income tax surcharge, but this measure was delayed in the House Ways and Means Committee, whose powerful chairman, Wilbur Mills, insisted on spending cuts as part of the tax bill.

So the Tet Offensive hit Washington at a moment when American economic hegemony was under siege. Unlike earlier military leadership requests for additional forces in Vietnam, the call for an additional 206,000 troops was reviewed by the Treasury Department. Secretary of the Treasury Henry Fowler foresaw the troop increase costing \$2.5 billion in 1968 and \$10 billion in 1969 and adding \$500 million to the balance of payments deficit. The costs would require at least the tax surcharge and the cuts in domestic programs of up to \$3 billion being demanded by Mills and other members of Congress. Leading business journals questioned the country's ability to finance the war at existing, let alone, higher levels.

A *Wall Street Journal* editorial said that the administration was “duty bound to recognize that no battle and no war is worth any price, no matter how ruinous.” A *Business Week* article said that Vietnam made clear “even the mighty United States lacks the means to fight anywhere, anytime, and prevail” and called for de-escalation and fiscal restraint. Clark Clifford, whom Johnson had just appointed Secretary of Defense, found “tremendous erosion of support” among the business elite, which felt the country was in a “hopeless bog...[and] getting deeper into the bog”—all of which seemed “mad.”

Rostow told Johnson that the “situation could turn into a crisis of confidence and feed on itself—much like a run on a bank.” This could result in “a serious contraction of international liquidity and pressure on all countries to adopt restrictive policies—at home and abroad—to preserve their gold holdings.”

On March 14 when the US lost \$3–2 million in gold trading, the Treasury Department requested that the London gold market be closed. Bankers representing the Western industrialized countries then met in Washington; they agreed to establish a two-tiered system to stabilize the price of gold: an official market where monetary authorities could buy and sell at \$35 per ounce; and a commodity market where price could fluctuate with supply and demand. Those measures stopped the gold pool hemorrhaging, but did not remedy the fundamental strain on the American economy.

For Johnson, the moment of truth came when he met with the so-called Wise Men on March 26. Comprised of a dozen or more former high-ranking officials, the Wise Men constituted, in a sense, the voice of the American Establishment. Johnson had on occasion called on them for advice on Vietnam, and they had been consistently hawkish, including their

most recent visit in November 1967. Now the tone of the Wise Men had changed. After briefings and discussion among themselves, the Wise Men met with Johnson.

Speaking for the group was its most senior member, the venerable Dean Acheson, the Secretary of State from 1949 to 1953, who told Johnson that the US could not prevail in Vietnam within a reasonable time with the means available. As usual, Acheson was blunt: “Together with our broader interests in Southeast Asia, Europe, and in connection with the dollar crisis, it requires a decision now to disengage within a limited time.” Johnson was shattered.

Clifford later wrote that, “speaking almost *ex officio* as the leader of the foreign policy establishment, and with his customary authority, Acheson had an unquestionable impact on the president.” Johnson had anticipated that the Wise Men would counsel holding the line at any cost, and he could not believe they had been so profoundly influenced by the events of the previous two months. Privately, Johnson said, “the Establishment bastards have bailed out on me.”

Yet Johnson could not deny the force of events. Reversing course in Vietnam was, as Clifford wrote, a “bitter pill” for the president. Until March 26 he seemed uncertain of what to do, for disengagement and the inevitable tax increase with budget cuts would end the dream of achieving victory in Vietnam and the Great Society at home. He gave two bellicose speeches in mid-March and privately he frequently talked of pursuing the enemy in the war. Yet by the last week in March, Johnson, still bitter and inclined toward self-pity, told military leaders that the nation simply could not afford the troop increase.

He ruminated, “That would cost \$15 billion. That would hurt the dollar and the gold... How can we get the job done? We need more

money in an election year, more taxes in an election year, more troops in an election year and more cuts in an election year.” And lastly, there was “no support for the war.”

So America’s involvement in the war was ended in part by the enemy’s surprising Tet assault, but also by a more fundamental flaw of great powers: the tendency to over-extend resources in order to hold distant lands, to allow ends to outstrip means. The financial crisis of 1967–68, epitomized by the run on the gold market, represented that sobering moment for the United States. **EH**

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Benjamin Graham in

By Dennis Butler

Perspective



Benjamin Graham (L), pictured here with General R.E. Wood, an official of Sears, Roebuck and Co., 1955.

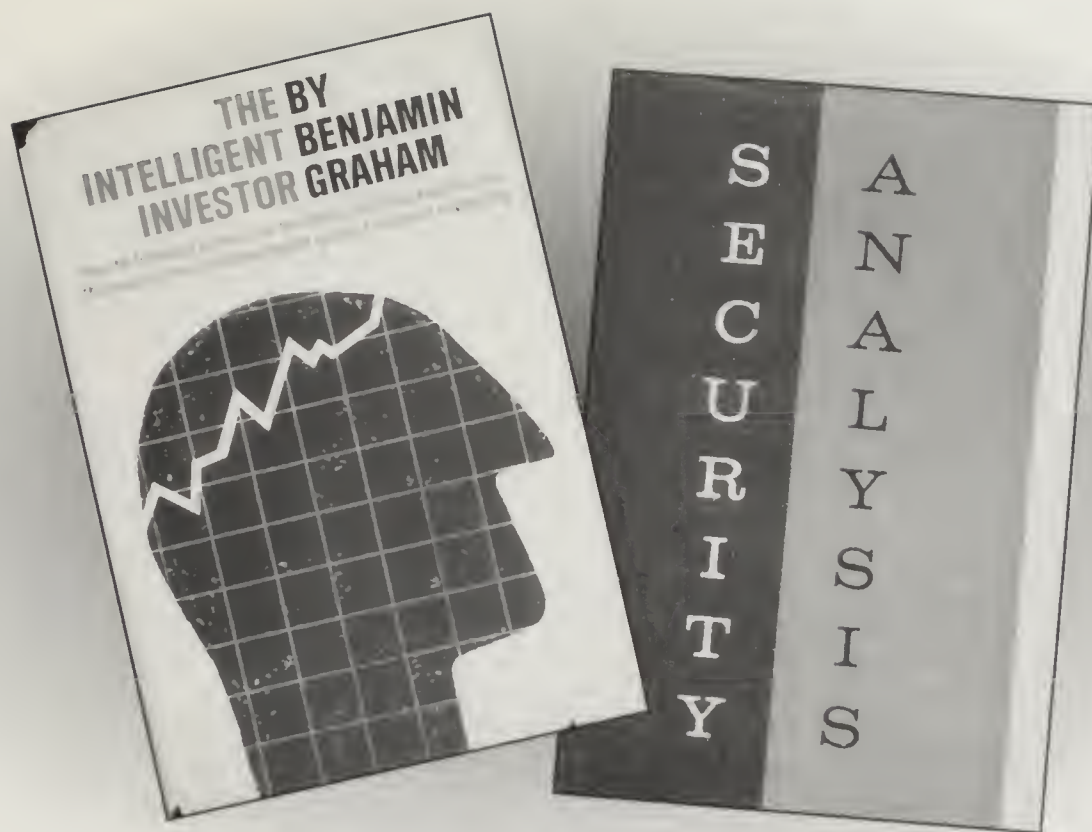
THE HISTORY OF INVESTMENT thinking is a neglected field, yet one of obvious value: our basic ways of approaching security analysis and investment, such as “growth” or “value,” are rooted in historical experience, practice, and ways of thinking. Names and instrumentalities change over time, but underlying issues, as well as the abilities and psychological makeup of investors, do not. A study of the craft’s past masters offers perspective and guidance to investors, much as politi-

cal history does to statesmen. There is, to be sure, an ongoing fascination with the market’s historical patterns and reactions to events. However, practitioners’ thinking about investment is a story lost to the majority of busy, practically-oriented investors.

Perhaps nowhere is the historical record less clearly understood than when it concerns Benjamin Graham, a central figure in 20th century investment practice and thought called the “father of financial analysis.” Graham

casts a long shadow over the field’s methods and professional structure, and his *Security Analysis* (1934) is known as the “Bible of Wall Street.” Terms such as “intrinsic value” and “margin of safety” are attributed to Graham. A school of investing—the “value approach”—views him as its patriarch. He helped to create professional organizations, including the New York Society of Security Analysts. Historical analysis reveals, however, that Graham’s contributions to investment *theory* were less significant for their originality than for their synthesizing quality. His actual contribution was to bring together and focus currents in investment thought already in existence. To appreciate that vital contribution and place his legacy in perspective, we must examine how conceptions of investing changed during the early 1900s.

In 1920, Graham issued a report stating, “if a common stock is a good investment, it is also an attractive speculation.” Although Graham (who in six years had risen from “gofer” to analyst at a brokerage firm) later claimed his assertion had been revolutionary, he was not alone. In 1917, Albert Atwood, in *The Exchanges and Speculation*, had similarly argued that “For a stock to be a good investment



Collection of the Museum of American Finance

Benjamin Graham's two most notable works are *The Intelligent Investor* (1949) and *Security Analysis* (1934).

it must be a good speculation." The language of these statements, familiar to market participants of the day, is somewhat puzzling to the modern reader, as is the reason why such pronouncements were controversial.

The "traditional view" held that securities transactions could be distinguished by the intentions and knowledge of the "operator." An *investor* aimed for secure income, with absolute safety of principal. Only bonds, protected by legal covenants and issuer assets, met these requirements. If your interest was to benefit from a change in market value—to buy "for the rise" or sell "for the fall"—then you were a *speculator*. Common stocks, with volatile prices and no secure income, were the primary focus, and speculators battled on the "fields of speculation,"—the stock exchanges. Investing had an aura of permanence, speculation, of opportunism. Finally, those who traded stocks recklessly, with little

experience or knowledge of the issuing companies, and usually on thin margins, were *gamblers*.

These distinctions were taken seriously. "Are common stocks investments?" was a legitimate, if quaint-sounding, question subject to stormy debate into the 1930s. Other observations appear equally odd or comical to the modern reader. For example, a speculator forced to hold a position longer than anticipated "became an investor" inadvertently. Conversely, investors with substantial profits would sometimes realize them, thereby "becoming speculators." People were surprised at the number of "speculations"—what we would now refer to as alternative, private equity, and venture capital holdings, or simply stocks—held in the estates of some of the era's great financiers, including the banker George F. Baker.

The investment-speculation distinction permeates the financial literature of the time. It was codified in the legal

system—in the "prudent man rule," and in state laws regulating savings institutions. Nevertheless, the traditional view was not universally held, and the line demarcating investments and speculations had always been fuzzy. The idea that one could only *invest* in fixed-income instruments or that investment was indifferent to appreciation came increasingly into question at the time Graham entered Wall Street.

Contemporary observations reveal this tension. In 1911 Thomas Conway claimed in *Investment and Speculation* that the investment-speculation issue was "an academic question to which we need give but little attention." Speculators and investors alike were alert to price trends. The speculator was an opportunist. The investor, although seeing himself as a long-term business partner, still was happy to see gains, and was inclined to sell if prices rose sufficiently. Edward Jones (*Investment*, 1918) said the *investor* must take

advantage of long-term price swings, weighing price and “intrinsic value,” and selling when securities were most profitable. David Jordan, author of *Jordan on Investments* (1919), a college text, wrote (employing a theme that figures prominently in Graham’s book) that “the name of a security has little to do with its investment status.” While not an “ideal investment,” a stock’s investment status lay in the issuer’s financial status (the ability to pay its dividend was crucial). Even Lawrence Chamberlain, author of the standard text *The Principles of Bond Investment*, acknowledged that investment and speculation were “inseparably related” and that appreciation was “properly and studiously sought for in an investment.” Investors were obliged to *speculate* to “obtain the greatest possible security for an investment.”

Around 1920 a new “profession of investment,”—investment counseling—came into its own. Investment counselors were professionals dedicated to the intelligent deployment of client capital based on research and experience, independent and free of the conflicts plaguing brokers and bankers. The work of these counselors expresses that era’s evolving thought about the nature of investing.

Morrell Gaines’s *The Art of Investment* (1922) offers an interesting transition from the traditional view. “Constructive investment,” as he terms it, is neither speculation nor the commitment of funds solely for income. Enhancing principal value is a legitimate goal, as long as income is maintained securely. Henry Sturgis, in *Investment, A New Profession* (1924), argues that investment entails speculation to some degree, speculation being (in a phrase suggesting Graham’s later definition of investment) “a transaction engaged in after careful study and consideration of all the relevant facts.” Stocks, says Sturgis, were “less unconservative” than blindly buying supposedly safe bonds. Acquired carefully, stocks’ profits offset the loss of

purchasing power. Purchasing power was also an issue for Dwight Rose in *A Scientific Approach To Investment Management* (1928). He writes of the difficulty equating conservatism with bonds, and speculation with stocks, if the result is to erode purchasing power. “Total return” is the proper objective of investment: both income and appreciation of principal.

For the new investment advisers, the investment-speculation distinction as traditionally identified with *types of securities* was disintegrating. Stocks, no longer *ipso facto* speculations, were, instead, a legitimate part of an investor’s portfolio. Interestingly, these views predated the publication of Edgar Lawrence Smith’s *Common Stocks As Long Term Investments* (1925) and Kenneth Van Strum’s *Investing In Purchasing Power* (1926), works implying that stocks were superior to bonds as *investments*, precisely because of stocks’ inflation-protection qualities. Unfortunately, Smith and Van Strum provided a theoretical justification for the disastrous New Era of the late 1920s, whose ultimate outcome—the 1929 crash—for a time undermined the idea that stocks could be legitimate investments. To their credit, a few of the new investment counselors had warned of New Era excesses.

There were other indications that the investment-speculation dichotomy was becoming increasingly strained. John Durand, addressing the equivalent of today’s “momentum” traders, writes, in *The New Technique of Uncovering Security Bargains* of 1928, of the modern “spec-investor” looking for capital appreciation opportunities. *Common Stocks and the Average Man* (1930) by J. George Frederick encourages the average man to “regard himself as an investment-speculator,” owning some bonds—traditionally the only appropriate investments for people of limited means—as well as “good common stocks” in order to share in the nation’s growth.

Philip Carret’s *The Art of Speculation* (1930) carries the concept of speculation as far as it can go; for his subject is not really speculation, but *investment* in the same sense that Graham would articulate it four years later. “The investor must speculate,” says Carret. To protect wealth from inflation, the investor “must consciously purchase a portion of security holdings with an expectation of profit.” Carret emphasizes the study of businesses, not market forecasts, and advocates purchasing “out of favor” stocks that are undervalued based on their *earning power*. In a phrase presaging Graham: “The road to success in speculation is the study of values.”

A common thread in these writings is a stress on “value.” As Gaines noted: “In the abstract, the investor needs to know only two things—the value of his security and the price at which it is selling.” Likewise, in a line hinting at Graham’s later “Mr. Market” parable: “The habit must be formed of sitting as a court of independent review on prices, aloof from the enthusiasms and pessimisms of the market place itself.” For Sturgis, investing was a matter of common sense, “based on a knowledge of what constitutes security values.” Rose observed that stocks had an advantage over bonds when purchased at an earnings yield (the ratio of earnings to stock price) exceeding bond yields—a value yardstick often employed by Graham. The reinvestment of earnings gave stocks a long-term advantage, but in a Graham-like note of caution Rose says stocks could be purchased with confidence “so long as the major part of excess earnings is not discounted in a greatly inflated market value.”

Thus, the notion of investment “value” predated *Security Analysis*. Indeed, the idea that securities had “intrinsic value” had appeared in financial literature for centuries and was incorporated into investment practice. Around 1720, Daniel Defoe

wrote of the hazardous purchase of securities at prices exceeding “intrinsic values” (Defoe had been caught up in the South Sea Bubble). Stockbroker and journalist William Fowler, in *Inside Life In Wall Street* (1873), frequently refers to a stock’s intrinsic value and the significance of value to operators such as Cornelius Vanderbilt. Henry Clews, a prominent banker of the late 1800s, wrote of buying stocks below their intrinsic values in his *Twenty-Eight Years In Wall Street* (1888). Likewise, “margin of safety” was a well-worn phrase used most often in bond analysis to refer to an issuer’s coverage of interest expense by earnings (or of dividends in the case of “investment grade stocks”), although this is not how Graham uses it.

The “study of values” implies principles and procedures. The first attempts to articulate fundamental investment principles began around 1900, and by Graham’s time, security analysis was playing an increasingly important and organized role. The evolution of investment thinking paralleled a transformation in American business. The early 1900s saw industrial corporations replace railroads as the dominant business entities. Large corporations, increasingly better financed and managed, gained greater political acceptance. Industrial stocks had become the “principal media of speculation” on the stock exchanges, taking over that role from railroad securities. With the growing capital needs of these organizations, Wall Street firms rose to the challenge. In demand were specialists trained to analyze the expanding number of issuers. Schools of business, such as those at New York University, Wharton, and Columbia, provided this training. Textbooks on industrial security analysis began to appear. Clinton Collver’s *How To Analyze Industrial Securities* was published in 1921; Walter Lagerquist’s *Investment Analysis*, the same year; Ralph Badger’s *Valuation of Industrial Securi-*

A Different Perspective on Graham

By Jason Zweig

As the editor of Graham’s book *The Intelligent Investor*, I thought I knew most of what there is to know about where Graham’s ideas came from. I was wrong. Dennis Butler’s article covers a great deal of ground that was new to me. I was particularly struck by Mr. Butler’s extensive citations of investing writers who came before Graham or were his contemporaries. This discussion is an important reminder that Graham was not a complete iconoclast but was also a product of his time.

However, the fact that most of Graham’s ideas came from somewhere else does not mean he was an unoriginal thinker. Graham had the genius to pull together strands of thought from many different sources and weave them into a precious new fabric that still bedazzles readers more than 70 years later. Graham blended insights from his mastery of mathematics, his decades of experience on Wall Street, his encyclopedic knowledge of classic literature and philosophy, and his profound understanding of human psychology – combining all these forms of learning into an analysis of investing no one has ever surpassed before or since. If Graham is not an original investing thinker, then who is?

King Solomon, in the Biblical book of Ecclesiastes, says that “There is nothing new under the sun.” Solomon was almost certainly restating an insight he got from some Hittite who, in turn, heard it from an Amalekite, who got it from a Babylonian, whose ancestors picked it up on the steppes

of central Asia. Does it matter how many people said it before Solomon?

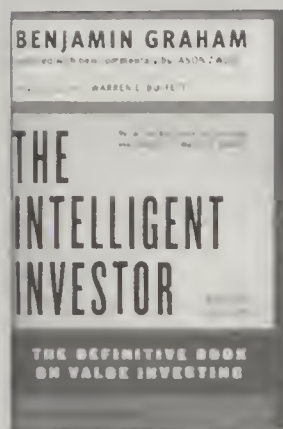
The quality of ideas is not diminished merely because they have precedents. Anyone who has studied the history of innovation knows that even the most radical ideas do not come out of nowhere; they all depend on everything that has come before. The telegraph was “invented” several times before Morse came along, Leonardo da Vinci learned from Verrocchio and Pacioli, Beethoven built on Haydn, and the Wright brothers and Henry Ford benefited from the collective tinkering of several generations. When Sir Isaac Newton explained his own breakthroughs, he declared, “If I have seen further, it is by standing on the shoulders of giants.” That does not negate Newton’s achievement. Nor is Graham’s greatness dimmed by knowing that some of his ideas had already been expressed, in weaker form, by other people.

Graham lives on, while his predecessors have been forgotten, because he turned many small thoughts into a handful of huge thoughts. His legacy is not about borrowing ideas, but owning them. Other writers may have defined “value,” discussed the margin of safety, hinted at “Mr. Market,” or touched on the distinction between investing and speculating. But none of them unified all these ideas in a single masterpiece of writing and analysis. There’s a very simple reason Graham is immortal: While he may have had precedents, he has never had peers.

For Further Reading:

Benjamin Graham (with Jason Zweig), *The Intelligent Investor*, 2003.

Robert K. Merton, *On the Shoulders of Giants*, 1965.



ties, 1925; and Carl Kraft and Louis Starkweather's *Analysis of Industrial Securities*, 1930. Other texts, such as Chamberlain's standard work on bonds, first published in 1911, went through several editions, as did Jordan's *Jordan on Investments* of 1919. The emphasis was on bond analysis—especially in the earlier volumes. Many analytical themes from these volumes, as well as an emphasis on careful analysis and the analyst's duty to make the accounting adjustments needed to reveal true earning power, later made their way into Graham's *Security Analysis*.

The preceding discussion should make the opening chapters of the 1934 text—encompassing Graham's remarks on investment and speculation, the breakdown of the traditional view, and the impact of the Great Crash on investment thinking—more understandable to the modern reader. Remaining to be considered is why the book is considered groundbreaking. There is, for example, no indication that Graham sought to invent a “value approach” (the term does not appear in his writings until years later): that way of examining securities was not new. Nor did *Security Analysis* make its chief author the “father of financial analysis”—an already flourishing field. Instead, *Security Analysis* occupies an important place in the history of investment thought due to its “proposed definition of investment,” namely: “An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative.”

This definition's basic elements—“thorough analysis,” “safety of principal,” and a “satisfactory return”—were not only familiar, but lay at the heart of the traditional view. They were also essential to advocates of “value” in security selection—to avoid “greatly inflated” market values. Graham's definition is, indeed, a culmination of the trends in investment

thought during the previous 20 years, and a synthesis of the traditional view and the ideas of the new investment professionals, forged after the 1929 debacle. The effect was to *operationalize* investing, making it a matter of procedure and *measurement*—and consequently no longer identified with any particular type of security. Hence, *Security Analysis* was not organized according to the system of security types customary in finance texts—“corporation loan,” “civil loan,” and so on—but according to the analytical procedure appropriate in any given case: for example, “fixed-value investments” or “senior securities with speculative features.” Investment dealt with the security's actual interest in, or claim upon, an economic entity. Stocks were investments if selected according to analytical procedures and safeguards relating to valuation and diversification. A bond could be a speculation—even a *gamble*—if purchased blindly, without proper analysis.

These philosophical matters do not account for the acceptance, popularity, and enduring influence of Graham's work. Denizens of Wall Street are of a more practical and materialistic bent, so we must look for more worldly explanations. Graham's prior experience probably had much to do with the success of *Security Analysis*. He had been a brilliant practitioner for two decades prior to becoming the author of Wall Street's “bible.” An established reputation brought credibility. He was an engaging writer. For readers of other texts of that period, his book stands out. It is laced with examples—some current at the time of publication. It is written with a clarity and ease of style, even humor, seldom found in such works. The text was a practical “how to” manual that explained the “study of values” in concrete terms. Its appeal to those seeking to divine the secrets of Wall Street was understandable.

Graham was also an outstanding teacher. By 1934 he was well estab-

lished at the Columbia Business School and was popular among Wall Streeters. His course offered a theoretical foundation and also an opportunity for practical application (students often attended just to get investment ideas). He developed a following that would carry his methods forward to the present day—an ongoing tribute to the master. These more practical considerations are what has really attracted attention to Graham and his writings over the years. More esoteric matters, including his role in the old debate over investment and speculation, are largely forgotten.

In *The Intelligent Investor*, Graham laments the loss of the investment-speculation distinction, arguing that its simple conceptions of motivation and risk facilitated clear thinking about securities. When investors bought bonds and speculators traded stocks, even mentally lazy “operators” knew where they stood. However, when investment became a matter of procedures instead of titles, everyone played with the same toys. The distinctions were less obvious, and the costs of laziness greater. Graham warned of the risks resulting from people not clearly understanding what they are doing, and of the danger to Wall Street's credibility and capital. Ironically, the fading away of the old investment terminology may very well be one of Graham's own legacies: his endeavor to more clearly define *investment* has helped to foster the belief that mere ownership of a few shares of stock makes one an *investor*—even when they were acquired as a *speculation*. **PH**

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Recollections From Four Decades on the NYSE Trading Floor

By Peter Low

LAST APRIL, I CELEBRATED my 43rd anniversary as a Member of the New York Stock Exchange. I was active on the Floor for 36 years—from 1963 to 1999—at which time I joined The Griswold Company in sales and marketing.

I still retain my seat on the New York Stock Exchange and I am still a Member in good standing—but even in this environment of penny differentials I still dream in eighths and quarters.

My father was active on the Floor as a trader and broker from 1937 to 1986 and my grandfather, who died before I was born, was the specialist in US Steel during the Crash of 1929.

In the early 1960s with daily volume of 4 or 5 million shares, 2,500 shares was considered to be a large order, and it would be months before I was entrusted with the responsibility of handling any order over 500 shares. By the time I left the Floor, I was amazed that young brokers with only a few weeks' experience were working orders as large as 100,000 shares or more.

I had a Securities Markets professor at the University of Vermont who, in 1961, predicted that within a few years New York Stock Exchange volume of 10 million shares would be a daily occurrence. He also thought that the US economy would eventually produce a GDP of one trillion dollars.

My father was very skeptical about these "wild" forecasts.

JFK Assassination

At about 1:30 PM on November 22, 1963, I was standing on the NYSE Floor with Harry Neufeld, the specialist in Polaroid, when a broker named Jimmy Phillips walked past and said, "Fellas, the president has been shot." There was an immediate groundswell of noise and activity. I vividly remember the uproar and confusion at Post 2—US Steel was trading at three different prices simultaneously as brokers scurried to get their orders executed.

Finally, at 2:07 PM, Walter Frank, vice chairman of the Exchange, rang the bell to close trading. It would not be until the Crash of 1987 that I would again experience that degree of turmoil and pandemonium.

My Word is My Bond

The cornerstone of the New York Stock Exchange Agency Auction Market is the integrity demanded by the theory that a broker's word is his bond. In fact, by making a verbal statement, a broker can actually obligate himself beyond his original intent.

In the mid 1960s, as is the case today, Floor brokers were forbidden from effecting transactions for their own account while being physically

present on the Floor. However, a member could apply for status as a Registered Trader. This class of membership was granted on Floor trading privileges under strict rules and regulations. In fact, my father acted in this capacity for many years.

At this time, American Motors was a very active stock and it attracted the interest of Registered Traders as well as that of brokers representing public orders.

One morning, a large crowd consisting of Members bidding for a substantial amount of stock gathered at the specialist post where AMO was traded. Bert Foley, an experienced and serious broker representing Dean Witter & Company, walked in and inquired about the degree of interest on the buy side of the market. A brash, presumptive, young Registered Trader said, "we are bidding for more than you have for sale." This was a dangerous statement because this trader had no way of knowing the extent of Dean Witter's sell interest. Foley then said, "Young man, I hope you have enough money because you are going to buy whatever the rest of the crowd does not take."

As it turned out he was forced to purchase about 10,000 shares, which was a substantial position in the mid-1960s. He protested to Exchange officials and proclaimed that he was merely joking. Nevertheless, his verbal



Courtesy of Peter Low

Peter Low (C) with fellow NYSE Members on the Exchange Floor, 1967.

statement was considered to be an actual financial obligation, and under the rules of the New York Stock Exchange he was deemed to have entered into a binding contract.

Practical Jokes

The playing of practical jokes has always been part of the culture on the Floor of the New York Stock Exchange. These antics serve to relieve tension in an atmosphere otherwise fraught with intensity and serious business focus. Freshman brokers are often the targets of this type of horseplay, but I remember one particular occasion when a celebrity guest was not immune.

One day in the early 1970s, the actor Kirk Douglas visited the Exchange. Charles Wohlstetter, a specialist who eventually became

chairman of the Continental Telephone Company, escorted him around the Floor. Charlie was very well connected with show business people through his wife, Rose, a former professional dancer. In addition, Rose Wohlstetter was very friendly with Joyce Matthews, a famous showgirl who was married to the comedian and television personality Milton Berle. Charlie also served as an executor for the estate of Billy Rose, the well-known entertainment impresario who at one time was the largest individual shareholder of AT&T. He was also a natty dresser with impeccable tastes and a keen sense of history. He not only owned a vineyard in France, but the desk in his study was originally made for Napoleon Bonaparte.

Charlie walked his famous guest into the annex, which because of its blue colored walls is still known as the "Blue Room." In an instant, a broker from Josephthal and Company snuck behind the two men and powdered the elegant suede shoes of the renowned actor.

As a rule, the victim of this type of prank would stamp his feet to rid himself of the powder and everyone around him would shout, "it's snowing in New York." It was all in good fun and was usually accepted as a harmless shenanigan. However, Mr. Douglas was not amused, and during the traditional chant he turned red with anger and embarrassment. All of us who witnessed this incident will always think of Kirk Douglas as a great actor, but a poor sport.

The Crash of '87 and the

Floor Members Emergency Fund

In the mid 1970s a group of brokers began an organization called the Alliance of Floor Brokers. We tried to limit the size of orders entering the new DOT system to 100 shares—we were Luddites and were paranoid about the possibility of technology putting us out of business.

As volume continued to expand it became apparent that more technology was going to be necessary.

In the early 1980s, men like John Phelan and Dick Grasso insisted that people on the Floor continue to adapt to further computerization. Without new systems it would have been impossible for the Exchange to handle the activity of 1987, the 1990s, and today's volume.

In 1986, a Floor broker named Bill Higgins was instrumental in starting a self-insurance fund for unaffiliated brokers, called the Floor Members Emergency Fund (FMEF). The object of this endeavor was to insure independent brokers against catastrophic losses due to errors incurred in the normal course of transacting business on the Floor.

Each member who joined contributed \$2,500 and signed a callable note for an additional \$2,500. In addition, the fund had specific guidelines as to that which constituted a covered error or miscommunication.

Brokers who had errors above a \$10,000 deductible amount would appear before a panel consisting of three to five fund participants. After considering all of the facts and circumstances, the panel would make a recommendation to the FMEF Board. The Board would then make a final decision as to the amount of indemnification to be awarded.

The importance of the FMEF became evident a year later. The Crash of 1987 was rife with extreme volatility and violent swings in securities prices. Chaos and confusion

are always ingredients of panic situations, and during the week of October 19, 1987 many Members incurred errors amounting to hundreds of thousands of dollars. In spite of the fact that the backup notes were called, the FMEF was a great comfort to many who otherwise could have faced personal ruin. The FMEF is still active today, providing an important safety net for the Floor community.

Wall Street Culture

As the son and grandson of New York Stock Exchange Members, I have a deep interest in Wall Street culture, and I think you will enjoy a few historical anecdotes.

The most fascinating man I knew during my years on the Floor was Mr. John A. Coleman. Mr. Coleman, the son of a New York City policeman, started as a page in 1916. By 1943, with little formal education, he had



Peter Low and his father, Arthur, also a NYSE trader and broker, ring the NYSE closing bell on the occasion of Arthur Low's retirement in October 1986.

Courtesy of Peter Low

become chairman of the New York Stock Exchange. Since, as I mentioned, my grandfather died before I was born I was very interested when his friend, Mr. Coleman, told me stories about my family.

In the 1940s, '50s, and '60s Mr. Coleman was probably the most prominent Catholic layman in the United States. He was well known as a philanthropist and as an adviser to politicians and business leaders. He served on many corporate boards, such as The Chrysler Corporation, The ABC Companies, and New York Telephone—none of which are independent companies today.

He was active as a fundraiser for Jewish and Protestant charities, as well as for the Catholic Church. His epitaph on a plaque in the John A. Coleman wing at Saint Vincent's Hospital in New York City is most inspiring. It memorializes him as "Counselor to the powerful, friend to the poor."

Mr. Coleman had a very concise way of expressing himself and also had a gift for getting to the heart of a situation. During one conversation in 1973, I expressed my concern about a number of pressing issues facing the New York Stock Exchange at that time. He told me not to worry too much and then he said, "Son, I've been around a long, long time, and I've seen the end of the world 100 times."

Another interesting gentleman was Tony Kerrigan who was a Floor broker for Merrill Lynch. Tony had a profound interest in world history and was constantly recommending interesting books and articles. He also took an intellectual approach to investments and the stock market.

In 1969, Tony told me that the smartest man in America was living in Omaha, Nebraska and that very few people had ever heard of him. He told me the story of how Warren Buffett had started in 1956 with \$105,000 raised from family and friends, and had recently closed his fund because he found it increasingly difficult to

find value situations. He also told me that at that time, Mr. Buffett had a net worth of \$25 million—and that was in 1969 dollars.

Another good friend, Michael Robbins, was a Floor broker for Donaldson Lufkin & Jenrette. One morning in 1974 he called his trading desk to tell them that he heard that Warren Buffett was investing in Reynolds Tobacco. A trader got on the phone and said, "Who the hell is Warren Buffett, you buffoon—get back to work." A few years later, after leaving Donaldson, Mike became the architect of an elite and well-respected Floor-based business catering to investment advisers as well as to corporations involved in share repurchase programs. He also served three terms as a Director of the Exchange.

In 1996, I called Bob Hagstrom, author of *The Warren Buffett Way* and other investment books, to ask his opinion of the newly-listed Berkshire/B shares. He told me that at \$1,200 or \$1,300 he felt that the stock was overpriced.

I love Bob's books and I have learned a lot from them, but I'm happy that I ignored his valuation.

In 1998, I met Mr. Buffett in Dick Grasso's office. When I told him that I was the proud owner of Berkshire/B shares in my retirement account, he said, "Well, I hope you're pleased with our performance."

A few months after that meeting I was searching the Internet for a book review of *Titan*, Ron Chernow's biography of John D. Rockefeller Sr. and I came across Mr. Rockefeller's original 1937 obituary from *The New York Times*.

Knowing that Mr. Buffett is an inveterate reader of financial history, I sent him a copy of the obituary. Four days later my wife called me on the Floor to tell me that Mr. Buffett had sent me a personal thank you note. Since I collect letters and documents, the original is on display in my den at home.

Value Investing

As far as value investing is concerned, during my career I have seen my New York Stock Exchange seat sell for as low as \$35,000 and as high as over \$3 million.

In the 1970s the *New York Post* and the *Daily News* ran stories about how a New York City taxicab medallion was selling at a higher price than a New York Stock Exchange membership. In 1975 a financial reporter named Chris Welles wrote a book called *The Last Days of the Club*, which predicted that the ending of fixed commissions would lead to the demise of the Exchange.

During that time, with seats selling at about \$50,000, a friend who was a partner at Goldman Sachs told me that Goldman had recently done a feasibility study indicating that it was economically impossible for a seat to ever again sell above \$150,000. He suggested that I consider selling my membership if prices were to ever again reach that level. Once again, I'm happy that I did not listen to the "smart money."

I am very proud of the fact that transactions representing billions of dollars are completed daily on the Floor of the NYSE by word of mouth. When a trade is consummated there is no signed contract, or even a handshake. There are no attorneys and no accountants involved—and it has been that way for 214 years.

The New York Stock Exchange has adapted and evolved throughout many upheavals and changes over its long history. Current challenges include ever-increasing automation and the transformation from a not-for-profit corporation to a publicly owned company. Its future, however, continues to depend on the integrity and good faith of its Members and practitioners. **FH**

Peter Low is a Managing Director and Senior Advisor at the Griswold Company, Inc. He was previously an independent Floor broker and has been a Member of the New York Stock Exchange for more than 40 years.

The First Wall Street:

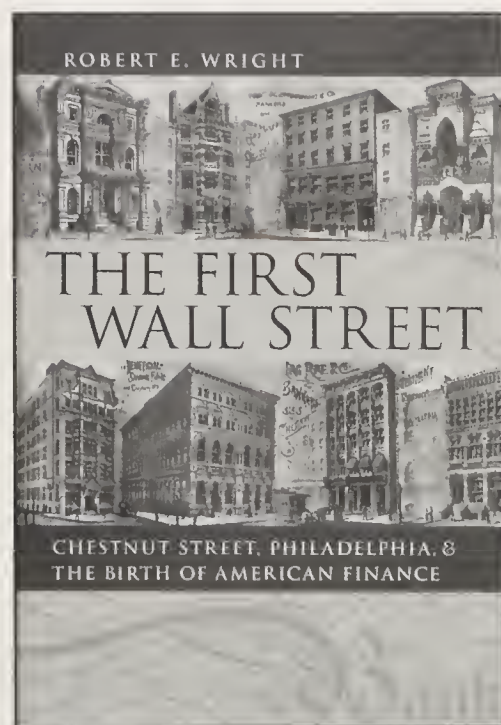
Chestnut Street, Philadelphia, and the Birth of American Finance

By Robert E. Wright

University of Chicago Press, 2005

210 pages with notes and index; no illustrations, \$25.00

Reviewed by Michael A. Martorelli, CFA



To thousands of people who work in the buildings that line it, Wall Street is a physical place. To millions more who will never see those buildings, Wall Street is the phrase that symbolizes the nation's financial system. Businessmen and other citizens of the "new" United States of America in the 1790-1835 period considered Philadelphia the cockpit of that system. The structures that lined that city's Chestnut Street were the birthplaces of the institutions that were the key elements in that system. Financial historian Robert E. Wright wrote *The First Wall Street* to describe the establishment of those institutions, and the innovative financial minds behind them, to today's businessmen and citizens, and he has succeeded at that task.

This book is about more than just the institutions and practices developed by the US's first generation of financial innovators, most of who lived and worked in Philadelphia. It also discusses the importance of a strong financial system to any emerging nation seeking economic growth. In detailing the intense innovation in banking, insurance, securities markets and monetary policy that characterized the early decades of the United States, the author helps explain the evolution of the US from an important colonial center to an emergent world power. Further, in describing the shift of the country's financial center from Philadelphia to New York that characterized the 1820s and 1830s, the book provides some lessons about innovation, regulation, and competition that should not be lost on the current denizens of Wall Street.

Philadelphia emerged as the political and economic capital of British North America when the US was not preordained by any supreme being, government institution, or overwhelming natural geographic advantage. The city's location on a relatively shallow and frequently-frozen river was not the most suitable in the colonies for transatlantic trade. And its intermittent yellow fever epidemics did their part to restrict commerce and cause panic among the citizenry. But the Quaker republic founded by William Penn became a bastion of freedom, and that freedom brought out the best in all quarters of

society. It was the one large city in the colonies where religious, political and economic freedoms appeared to be most widely recognized by the town fathers. Innovators from the other colonies found in that city the right conditions to develop and implement their ideas for the economic institutions and business practices that would spur the growth of the entire country's economy.

The author uses the first third of the book to set the stage for his story and to describe at least some of the broader political, economic and social attributes of Philadelphia during the colonial period. He intersperses his description of new financial tools with stories about their usage by landlords, merchants, manufacturers, and tradesmen. He traces the financial evolution of the US as it changed from a British colony to a loose confederation of independent political subdivisions to a nascent union of states bound by a common constitution. A large number of industrialists, scientists, architects, artists, physicians, and even lawyers also contributed to the creation of what portrait painter Gilbert Stuart called "the Athens of America" when referring to Philadelphia in the first quarter of the 19th century. Wright does acknowledge some of the contributions of other men and other cities to the growth of the US in that period. Yet there would seem to be some merit in placing the evolution of the new country's financial system in context with such far-reaching

political actions as the Louisiana Purchase, the War of 1812, and the opening of the Erie Canal.

Wright uses the middle of the book to describe the most important and innovative financial thinkers of the period, and the institutions they developed. It can be considered the heart of the book by those focusing more on the specific financial institutions (and the innovative minds behind them) and less on the broader sweep of the country's economic development and the shifting of the center of its financial system from Philadelphia to New York. In each chapter, he includes a fair amount of educational material explaining the nature and roles of the money supply, a central bank, commercial banks, property and life insurance, securities markets, etc. Those explanations are useful, but sometimes they interrupt the flow of the story being told, and might have been better positioned in an appendix or glossary. These chapters can be read in sequence, or as independent descriptive passages.

One short chapter breaks the pattern and stands apart as a description of the city's transportation system as it evolved from about 1770 to the 1830s and even a bit beyond. Particularly instructive are the descriptions of the alternate transportation routes to the sea that were developed by those who settled the hinterlands as the country spread inward from the Atlantic seaboard. Throughout the first third of the 19th century, those shipping produce, coal and other goods from eastern Pennsylvania and the Delmarva Peninsula still used Philadelphia as their major destination and their route to Europe and the Caribbean. However, with each passing decade, more trade from central Pennsylvania migrated down the Susquehanna River, into the Chesapeake Bay and through Baltimore.

The settlers of western Pennsylvania found the Allegheny, Ohio and Mississippi Rivers more efficient routes to the marketplace of New Orleans. The expanding Midwest region and interior New York State found the Erie Canal an efficient route of commerce to New York City, and then elsewhere in the world.

The shifting of commerce to other ports was an important element in the erosion of Philadelphia's economic dominance of the country. At the same time its volume of national trade was peaking, the first generation of innovative financial thinkers passed on to their reward, and gave way to a new generation of men who just did not have the vision of their forefathers. Wright notes that the single word "hubris" described precisely the city's second-generation financiers. Others have noted the ossification of the city's upper class and its focus on one's background and upbringing rather than one's ambition, drive or creativity. Many innovative, non-Quaker-like entrepreneurs in New York, Baltimore, Chicago, and New Orleans were willing and able to wrest the control of trade and finance from the City of Brotherly Love.

The penultimate chapter tells of Nicholas Biddle's management of the Second Bank of the United States, and of the campaign against that institution by New Yorkers such as DeWitt Clinton and Martin Van Buren. It was not hard to convince Andrew Jackson to sanction the reauthorization of the bank's charter. Philadelphia's reign as the nation's financial capital may have officially ended in 1836 with the closure of that bank, but its decline in importance to the growth of the economy was well underway by then. The author's closing description of the economic growth of this now second-class city beyond the 1830s is painful

for a native Philadelphian to read, but accurate nonetheless.

Robert Wright is certainly not the first author to detail the work done by Alexander Hamilton, Robert Morris, Thomas Willing, or Steven Girard. Nor is he the first to explain the origins and contributions of our country's first *de-facto* central bank, and the initial and largely successful experiments with private commercial banks, marine/fire and life insurance companies, savings banks, building and loan associations, and securities markets. He has, however, contributed to a new audience's understanding of this history and brought attention to such lesser-known early financiers as Michael Hillegas and Clement Biddle. He has also woven throughout the book the individual stories of numerous artisans, merchants, and industrialists who were able to build prosperous careers, thanks in large part to the soundness and efficiency of the financial system that then prevailed. For readers craving more information, the author uses 14 pages of notes to cite the works of authors such as Ron Chernow, Bray Hammond, Thomas Doerflinger, and Wright himself to point out sources of more detailed descriptions and analyses of various topics. All in all, Robert Wright has produced a worthwhile volume that should be read and appreciated by a wide variety of financial history buffs, businessmen, and ordinary citizens. **PH**

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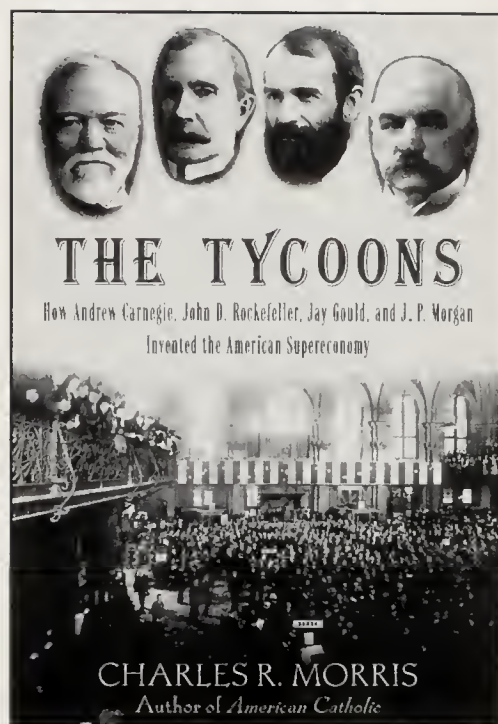
The Tycoons: How Andrew Carnegie, John D. Rockefeller, Jay Gould, and J. P. Morgan Invented the American Supereconomy

By Charles R. Morris

2005, Henry Holt

382 pages with photographs, illustrations, appendices, notes, and index. \$28.00

Reviewed by Gregory DL Morris*



REGULAR MAGAZINE READERS and friends of the Museum will not find a great deal new in the pages of *The Tycoons*, but Charles Morris does take an interesting and innovative approach. By just going on about their business the four plutocrat protagonists in *The Tycoons* changed the way the world did business, and vaulted the US to an economic primacy that looks to remain unchallenged for the foreseeable future.

Three of the four, Carnegie excepted, have been the subjects of excellent recent biographies. The other three tycoons appear in each of those books, but only as refractory figures for the main subject. In *Tycoons*, Morris tries to keep all four on stage all the time. The problem, however, is that to the extent they

were contemporaries, they worked together infrequently. When they did, it was usually only in pairs, and not for very long.

Morgan financed a good bit of Gould's western railroad building, and of course also the assembly of US Steel from Carnegie Steel. As Morris details, Carnegie himself did not like J.P. Morgan, and preferred to do business with his father, Junius. Rockefeller mostly went his own way. Morris's premise is ambitious, but in the end he ends up with a series of duets and a few solos, instead of a quartet.

Perhaps to address the querulous independence of his characters, Morris lays on top of the interwoven business biographies a grand unifying theory of almost inevitable American economic greatness. For prologue, Morris cites Abraham Lincoln.

"His speeches emphasize again and again the exceptionalism of America, where the broad populace enjoyed the social and economic underpinnings of political freedom... What country of Europe, presented with a vast wealth of unexploited resources, would have conceived of giving it to its people? Or consciously set out to make its citizens economically independent?"

Through the Civil War and the Industrial Revolution, Morris details, sometimes exhaustively, the industrial, economic, social, and cultural developments that put the US ahead of Europe. He identifies the Panic of 1873 as the last wrenching of the pre-industrial economy.

"Seizing on the openings created

by the 1873 crash, Carnegie, Gould, and Rockefeller all played primary roles in driving the [industrial] scale shift.... Morgan plied his trade as a banker, and would emerge after yet another market break in the 1880s as the regulator of machines that other people built."

Morris's other thesis point is that the rise of America as an industrial giant was in conjunction with and dependent upon the rise of the Middle Class. "None of the Morgans, or Loeb's, or Belmonts, or Barings, who shoveled billions of dollars into American railroads, and telegraphs, and steel mills, and iron and coal mines, thought about selling wrapped and scented ladies' soap. But that, it emerged, was what all the infrastructure was for." Morris also notes that the huge corporations employed many thousands of "white-collar" workers themselves, creating a huge salaried white-collar work force.

A lawyer and former banker, Morris is clearly very comfortable with his material, and occasionally slips into overgeneralizations or even glibness. He is also endlessly fascinated with details. The material never gets dense, but it does tend to lose focus in many digressions. Nevertheless Morris has delivered a fresh path along well-worn ground. His turn of phrase can be quite charming, and his vocabulary is expansive. **FH**

*Gregory Morris is not related to Charles R. Morris

TRIVIA QUIZ

How much do you know about financial history?

By Bob Shabazian

1. What two major developments in American finance occurred in 1913?
2. Where was the world's first stock exchange?
3. What bearish investor, described as Wall Street's first manipulative operator, is said to have devised the idea of the short sale?
4. What federal agency is housed in the Eccles Building in Washington, DC?
5. What former US president said he wanted an economist who was one-handed?
6. Why was green ink used when the government introduced small-sized certificates and banknotes in 1929?
7. What business magnate introduced the "Five Dollar Day?"
8. What company installed the first "movie ticker" at the New York Stock Exchange in 1923, featuring a projector and lens designed to project a newly developed translucent ticker tape?
9. When the US government recently introduced the new colorized version of the \$10 bill, why was the unveiling ceremony held at the National Archives instead of the US Treasury, the Bureau of Engraving and Printing, or the Federal Reserve Bank?
10. What was the name of the first car Henry Ford built?

1. Creation of the Federal Reserve Board and the states' ratification of federal income tax laws.
2. Amsterdam (17th century)
3. Jacob Little
4. The Federal Reserve Bank. The building is named after Marriner S. Eccles, who served as Fed chairman from 1934-1948.
5. Harry S. Truman because his economic advisers would typically give him advice stating, "On one hand... but on the other hand..."
6. Green ink was readily available in large quantities, and the color had a relatively high resistance to chemical and physical changes.
7. Henry Ford in 1914 offered \$5 a day for an eight-hour shift. The \$5 figure was reached by adding profit sharing and other conditions.
8. Trans-Lux. Two years later, the company listed on the New York Curb Exchange, precursor to the American Stock Exchange.
9. The new bill features in red letters the phrase "We the People" from the US Constitution, which is housed in the National Archives.
10. The Quadricycle, made in 1896 using a combustion engine developed three years earlier.

Message to Members

continued from page 5

years for general government operations. The federal deficit would be at least \$1 trillion bigger without the use of the Social Security surplus. By 2030, however, Social Security will have an annual deficit of about \$250 billion. But even this deficit is not as severe as the one projected by the recently passed Medicare prescription benefit, which will likely total at least \$8 trillion as presently constituted – 150 percent more than our currently calculated Social Security benefit.

The panelists also noted that all of the money Americans pay into their payroll taxes for Social Security and Medicare is not set aside, but is spent on ongoing government operations. According to Secretary Peterson, the trust fund is an oxymoron; "it shouldn't be trusted and it's not funded (solvent)." The trust fund is in effect simply a ledger book of IOUs that our children and grandchildren will have to pay off.

3. The participants also pointed out the unacceptability of running huge budget deficits while promoting tax cuts (the net operating deficit of the US government in fiscal 2005 was \$760 billion, said the OMB). It was also agreed that the current account deficit, at a stunning 7 percent of GNP, is at a level at which no country can continue indefinitely by borrowing from abroad.

Supply side economics was referred to in this connection as "when foreigners supply most of the goods and all of the money." The US has to attract around \$8 billion of foreign capital every day to finance its current account deficit, and some panelists said they believe the US has become dysfunctionally dependent on foreign capital – even recklessly dependent. The panelists mentioned that a former Fed Chairman is warning of a possible dollar crisis as the demand for dollars (to buy US Treasuries, etc.) is unlikely to continue – with all that implies for a hard recession and increased taxes.

Given our unsustainable deficits, either our entitlement benefits must be reduced or taxes greatly increased. For politicians, that's a Hobson's choice, requiring courageous leadership willing to accept a level of pain today for a future leader's gain. **PH**

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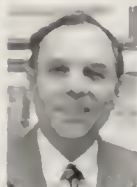
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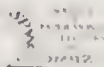
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